

## **Roll On/Over Columbia**

*A blue "white paper" on Bonneville issues affecting Montana* [revised 11/4/99]

Prepared for the Electric Utility Restructuring Transition Advisory Committee

Stephen Maly, Legislative Research Analyst

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**Preface.** The purpose of this paper is to provide factual information that will provoke questions from Committee members and other interested persons and to help provide a basis for the Electric Utility Restructuring Transition Advisory Committee's (TAC) decision regarding what stance or action to take vis a vis Bonneville Power Administration policies. This is intended as a briefing document, not a definitive summary. The author gratefully acknowledges assistance and cooperation of Gail Kuntz, John Hines, Debbie Smith, and others.<sup>1</sup>

### **I. Overview of Federal Power Benefits in the Pacific Northwest.**

The Bonneville Power Administration (BPA) is a federal agency, under the U.S. Department of Energy, that markets wholesale electrical power generated by 29 federal dams and one non-federal nuclear power plant in the Pacific Northwest. BPA also owns and operates most of the high-voltage transmission system in the Northwest, and maintains transmission links with other regions. Its service territory covers approximately 300,000 square miles, including the states of Washington, Oregon, and Idaho, the portion of Montana west of the Continental Divide, and such small portions of Wyoming, Nevada, and Utah that are within the Columbia River drainage basin. BPA supplies roughly 40% of the electricity consumed in the Pacific Northwest; it is directed by statute to sell power at cost. Prior to the deregulation of the wholesale power market in 1992, BPA's cost-based rate had traditionally been 20% - 30% below those associated with coal, oil, and natural gas generation.

The agency was created under the Bonneville Project Act in 1937, and its federally subsidized development took place in a post-Depression era when small farm and residential consumers were at the mercy of giant, monopolistic utilities and the Pacific Northwest had yet to become industrialized. From the outset, public utilities got first crack at BPA power. For nearly 40 years, the BPA produced a surplus, so what was not claimed by public bodies was made available to investor-owned utilities. In the 1970s, regional demand for electricity exceeded BPA's supply. In response, BPA stopped selling to investor-owned utilities. In 1980, the Northwest Power Planning Act restored utilities' access to BPA power under multi-year contracts, but the Act also reaffirmed the statutory preference and priority granted to public bodies and cooperatives under the Bonneville Project Act.

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<sup>1</sup>If there are errors and omissions, someone else is to blame.

The Act also created what's known as Residential Exchange program, whereby the BPA makes cash payments to Pacific Northwest utilities operating in the agency's service territory based on the difference between the utility's average system cost of its resources used to serve its customers and the price of BPA power. More on that later.

BPA is self-financing; it pays for its costs through power and transmission sales. Both power and transmission are sold at cost. BPA repays its construction and development debts to the U.S. Treasury with interest. The agency has 3 classes of customers: public utilities (public bodies and cooperatives), investor-owned utilities (IOUs), and direct service industries (DSIs). All electric cooperatives in Western Montana and the town of Troy fall into the public utility class; Montana Power Co. is an IOU, and Columbia Falls Aluminum is a DSI.

Pursuant to the Bonneville Project Act, public utilities continue to get first call on federal power. Under the Northwest Power Planning Act, BPA MUST meet the load demand of all public bodies within the agency's service territory. Public bodies are also entitled to receive power at the PF rate, which has historically been BPA's lowest-priced electricity, known as "preference" power. The other customer classes generally pay higher rates. Residential Load (RL) and PF Exchange Subscription rates are the rates BPA proposes to offer to IOUs who agree to a settlement of the Residential exchange program (explained below). Under the settlement, IOUs would purchase a specified amount of power or receive specified monetary benefits under a contract for their residential and small farm customers.<sup>2</sup> Industrial Firm Power (IP) rate is the rate charged to BPA's Direct Service Customers (DSIs), which are primarily aluminum companies. The IP rate includes a charge to recover BPAs costs of acquiring additional power to serve DSI loads.

Bonneville's contracts with nearly all of its 132 utility customers are set to expire in September, 2001. The agency has to continue to meet all of its financial obligation, including its "mortgage" payments to the U.S. Treasury, so it is imperative that BPA enter into new contracts for all of its power resources. To achieve this, the BPA has adopted a ***Power Subscription Strategy*** to guide its power sales contracting and rates beginning in fiscal year 2002. The Strategy seeks to implement the subscription concept created by the Comprehensive Review, a year-long review carried out in 1996 by the 4 Northwest governors of how the region's electricity system should be restructured. The Strategy is designed to provide the revenue base that will enable BPA to carry out its mission to bring low cost electricity to its Pacific Northwest customers, to meet all its environmental obligations (e.g., to mitigate damage to salmon in the Columbia Basin), and to spread the benefits of federal power as widely as possible to regional consumers. More specifically, the goals of subscription are:

™ In allocating benefits region-wide, give special attention to residential and rural customers;

™ Avoid rate increases through "a creative and businesslike response to markets" and aggressive

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<sup>2</sup> The RL rate is proposed to be equivalent to the PF rate in the current BPA rate case.

cost reduction;

™ Allow BPA to fulfill fish and wildlife obligations while ensuring a high probability of making payments to the U.S. Treasury; and

™ Provide market incentives for the development of conservation and renewable energy.

Another dimension of the Subscription Strategy is the settlement of Residential Exchange benefits. Section 5(c) of the Northwest Power Planning Act established the ***Residential Exchange Program*** (Rx)<sup>3</sup>, which provides participating Pacific Northwest utilities a form of access to low-cost federal power. Electricity--or cash-- is exchanged between BPA and the participating utility. Whenever a regional utility offers to sell power to BPA at the utility's average system cost (ASC), Bonneville buys the power and offers in exchange to sell an equivalent amount of electricity to the utility for distribution to the utility's small farm and residential customers. In practice, this is a financial transaction rather than an exchange of electrons. The difference between BPA's rate and the utility's ASC, multiplied by the utility's eligible residential and small farm load, determines the amount of benefits BPA pays to the utility to be passed through to the utility's residential customers. Both investor-owned and public utilities are eligible to participate.

The trick to ending the Rx is to equitably distribute BPA benefits throughout the Pacific Northwest. For a variety of reasons related to falling costs of new generation, electric industry restructuring, market trends, and BPA's statutory requirement to implement certain rate tests, IOUs in Idaho, Washington, and Montana--notably Montana Power Company--have not been in recent years beneficiaries of the Rx because their ASC has been lower than BPA's.

As architect's of the Rx Settlement calculus, the members of the region's four utility regulatory commissions recommended to the BPA that Montana receive 24 aMW out of 1900 aMW in combined physical power and cash for IOU residential and small farm customers through Subscription. BPA expects to issue a draft decision document in the near future, for public comment. The agency plans to render a final decision in December that will either confirm or modify this allocation.

In August of this year, the BPA published its initial proposal to set wholesale power rates (the price it charges to its customers) for the 5-year period between 2002 and 2006. What's known as ***The Rate Case*** is a quasi-judicial proceeding required by the Northwest Power Planning Act's Section 7(i), which governs the process of BPA's rate setting. The agency's rate proposals are tied to its Power Subscription Strategy.<sup>4</sup>

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<sup>3</sup> The BPA universe is chock full of acronyms already, so I made this one up. In addition, cheap power is like a drug.

<sup>4</sup>The FERC exercises limited oversight of rate cases, primarily to certify that BPA's prices are set high enough to ensure payments to the Treasury.

The Rate Case is laden with serious controversies that pit different customer classes against each other. A number of public utilities in Washington and Oregon and Oregon's Public Utilities Commission have filed lawsuits in the 9th Circuit Court of Appeals to challenge whatever allocation of power the agency makes. The plaintiffs contest BPA's proposal to sell approximately 1,900 average Megawatts (aMW) of the total 8,500 aMW produced by the federal system to the seven IOUs in the region. Other critics of BPA allege that commitments to supply about 1,500 aMW to aluminum smelters and other DSIs at below-market costs will be paid for with rate hikes charged to all other BPA customers, including residential and small farm consumers. The charge is that BPA has no legal obligation to sell to DSIs, whereas the agency is compelled by law to serve public utilities. At the same time, the IOUs would like the BPA to limit public utilities' purchases to the amount of low-cost power necessary to serve their residential customers--roughly 2,500 MW--and not industrial customers, who use about half the power public utilities buy from BPA. This would allow IOUs to buy the remainder, about 3,500 MW, for the benefit of THEIR customers. This outcome would require modifications to federal law.

## **II. The BPA and electrical industry restructuring: What's the intertie?**

The role of federal power in the restructuring of Montana's electrical industry was not expressly contemplated or addressed in Senate Bill 390, the 1997 restructuring act. In contrast, Senate Bill 406 was drafted, crafted, and signed into law with the conscious expectation that a buying cooperative might qualify for low cost power from BPA and would thus be in an advantageous position to pass these benefits on to small commercial and residential consumers by operating as the default supplier. The issues surrounding BPA exemplify a general theme: the results of anticipated and unanticipated consequences of federal level decisions could have a decisive impact on the real outcome of Montana's transition to competition in electrical supply.

Montana is so far the only state in the region to have undertaken full-scale restructuring at the retail level. Washington and Idaho are still investigating their options. Oregon has gone part way toward retail choice, by allowing industrial consumers to shop for suppliers and by providing residential customers with a choice of different product & service portfolios, but Oregon's statute prohibits IOUs from selling their generation assets without regulatory approval, so there is no immediate prospect of a Montana scenario anywhere else in the Pacific Northwest.

So much for context. Do Montana consumers get a fair share of the total amount of BPA benefits? How does one determine fairness? On the one hand, Montana has over 40 percent of the Columbia Basin's non-treaty water storage, and it also provides unquantified flood control benefits to the entire region. Since the Continental Divide marks the eastern boundary of the Columbia Basin, only about 1/3 Montana Power Company's service territory fits under the Rx umbrella. Meanwhile, areas in Washington and Oregon that are also outside the basin do not face the same exclusion. Furthermore, the state can point to the numbers: 24 aMW in Rx benefits is a mere 1.2% of the total proposed

allocation in the region, while IOUs in Washington and Oregon are slated to receive about 750 aMW and 850 aMW respectively.

The BPA can counter that the dollar value of per capita benefits provided to Montana consumers is higher than those in Washington, Oregon, or Idaho, and that the total aMW benefits per 1,000,000 population flowing to all types of customers in Montana are on par with those of Washington and Oregon, and greater than those going to Idaho. Montana is the only state in the region that benefits from two separate federal systems, Bonneville and the Western Area Power Administration (WAPA).

Fairness is not so easy to discern when there are different ways to do the regional math. On the federal side of the ledger is the power generated at the Hungry Horse dam, which, unlike any other hydroelectric facility on the Columbia River system, is reserved to Montana. The approximately 220 aMW generated at Hungry Horse is, strictly speaking, "system power"; however, the formula that governs the distribution of this power renders it unavailable to customers outside Montana. In effect, the state has a unique entitlement, no matter how much demand for electricity exists region wide. Historically, Columbia Falls Aluminum Corporation, Montana's big DSI<sup>5</sup>, was a beneficiary of the reservation; more recently, western and eastern Cooperatives have contracted for Hungry Horse power.

Montana also receives federal power benefits in the eastern portion of the state, provided through WAPA. (Whether these are relevant to a discussion of BPA power allocation is arguable.) More important, from both a state and federal perspective, is what Montana and the region stand to lose by "crashing the system" via some legal and/or political strategy that stalls the subscription process, jeopardizes BPA's ability to meet its financial obligations to the Treasury, and enhances the strength and credibility of the Bonneville system's detractors in other parts of the country and the Congress.

The following two issues are at the interface of state and regional perspectives:

**—Allocation of benefits to Montana (Public utilities; MPC's Rx Customers; DSIs)**

At BPA's request, the utility regulatory commissions of the four Pacific Northwest states recommended an allocation for the purpose of settling the Rx. In this procedure, Montana--meaning the residential and small farm customers served by Montana Power Company in the western part of the state--was awarded 24 aMW, or 1.2% of the total 1900 aMW available for Rx region wide. The 1900 aMW allocation means that 60% of the region's residents--those served by IOUs--will get 22% of the total federal power benefits available in the next 5-year contract period. It is useful to remember that IOUs

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<sup>5</sup>This reservation touches on an issue that is bigger and broader than Montana, mentioned earlier--the debate over whether BPA should be providing low-cost power to industries at all, given the agency's basic legacy and charter to protect small consumers from unaffordable price hikes.

don't qualify for preference power, and to point out that the 1,900 aMW total represents about 40 percent of the 7 regional IOUs total residential and small farm loads. From this perspective, Montana's allocation of 24 aMW is roughly proportional to what other states' IOU customers will receive in Rx settlement benefits.

The state, through the Governor's Office, has requested an additional 20 aMW, outside the Rx *per se*, which would boost Montana's regional share to 2%. The Governor's Office has been operating with the understanding that the current BPA Administrator would allocate 45 aMW to the state. This understanding has been challenged under pressure from the Oregon PUC and others from the more populous and politically powerful states in the region. The Governor's position aims to maintain a balance between spreading as broadly as possible federal benefits to residential customers of MPC and keeping BPA's preference scheme intact. (In this regard, the Montana Electricity Buying Cooperative's claim to an amount somewhere between 64 aMW and 110 aMW of preference power and the desire for a further 20 aMW to residential customers in MPC's service territory are probably not compatible.)

As mentioned earlier, MPC has received very few Rx benefits over the years, because its rates have been consistently below BPA's preference rates. MPC has and continues to contest the methodology BPA uses to calculate the utility's costs, and thus argues that its residential customers have been unfairly penalized by the federal agency's cost accounting.

— **Standards for Service:** who/what qualifies for preference power? BPA is about to issue a Record of Decision (RoD) which will preclude a public body that does not own a distribution system (poles and wires) from qualifying for preference power. The RoD will thus deny the Montana Electricity Buying Cooperative access to the region's lowest-price power, since the same statute that enabled the Coop's creation also expressly prohibits it from owning poles and wires. One of the reasons for this policy is that BPA is concerned that if it bent its rules to suit a singular entity in Montana--MEBC--other organizations in the region would structure themselves to qualify for preference and before long the agency would be forced to purchase more expensive power to augment a basically finite supply. This would drive up costs for all BPA customers, or cause the agency financial damage which would in turn generate political pressure from outside the region to dismantle the federal system.

Montana Power Company, the Consumer Counsel, the Public Service Commission, the Natural Resources Defense Council, the City of Missoula, and the Montana Environmental Information Center submitted joint comments to BPA on June 30. "Bonneville should recognize as a preference entity any public body default supplier in a state that has mandated (1) open distribution access; (2) public service commission regulation of distribution costs; and (3) a utility obligation to serve imposed on the default supplier." This combination of conditions suffices to meet BPA's statutory duties and its policy goals, according to the combined Montana contingent. Moreover, the group points to another federal power marketing agency, the Western Area Power Administration's (WAPA) proposal to sell preference

power to Indian tribes without the requirement that the tribal governments own their own distribution.<sup>6</sup>

Montana does not enjoy the luxury or leverage of a single position on these issues. There is no unified front. The Governor's Office's assertions challenge the BPA's treatment of Montana overall. Other parties to the conflict--MPC, the Coops, the MEBC--want to protect and preserve their respective (or prospective) share of federal benefits, all of which flow to Montana consumers in some fashion, but not to ALL of them equally. A shift in BPA's allocation of Rx benefits to MPC customers could have the effect of raising the price of preference power provided to qualified Cooperatives. The effect of a BPA decision to allow a buying cooperative to qualify for preference power would be similar, but even more pronounced.

### **III. Policy Options for the TAC**

What are the TAC's options? The Committee does not have a clear statutory duty to address BPA-related issues. Nevertheless, it is not constrained by law from pursuing one or more of the following courses of action:

A. *Do (almost) nothing: watch, wait, reserve judgment*; see how the RoD and any subsequent lawsuit to appeal its conclusion plays out; also wait and see how the BPA attempts to placate the Governors' Office demands for additional power outside the Rx settlement tranche.

B. *Communicate (in writing) concerns and a consensus position to Congressional delegation*, with the hope that one or both U.S. Senators and Montana's lone Congressional Representative will successfully exercise political leverage to compel BPA to award the state with a larger allocation. No member of Montana's delegation has as yet asserted a position. It is worth noting the obvious--that each of the other states in the Pacific Northwest has the same number of Senators as Montana, and that the combined clout of Oregon, Washington, and Idaho far exceeds Montana's in the U.S. House of Representatives.

C. *Participate in a regional forum on preference issues*. Who should qualify for preference? Should statutory preference be phased out of existence, given the trend toward deregulation? Discussion of these questions would not have any immediate affect on the Standards for Service or the Rx Settlement. However, engaging in this debate would take the TAC to the heart of matters that will determine the future of BPA and any substitute regional organization dedicated to preserving the comparative advantage the Northwest has enjoyed since passage of the Bonneville

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<sup>6</sup> WAPA operates under separate statutes, not under those governing BPA.

Project Act.

**D. *File (or join) a lawsuit in the 9th Circuit by petitioning to overturn BPA's record of decision on standards for service.*** Parties have 90 days subsequent to the RoD in which to formally petition the court. Under the Subscription process public utilities that qualify under BPA's Standards for Service have 120 days after the Rate Case decision is issued to enter into contracts for power. This "window of opportunity" to obtain preference power will close by August 1. The agency has a 14-0 record against various plaintiffs in the 9th Circuit. The BPA has never lost in court, but it has made concessions and adjustments through legal settlements on some occasions. The cost of litigation is presumed to be high. In the event of a plaintiff's victory, implementation of a remedy may be problematic, as the MEBC might not have legal standing to receive and distribute benefits won in the court proceeding. On the other hand, as mentioned above, BPA is being sued now by a cadre of public utilities and DSIs elsewhere in the region over the allocation of benefits and further legal action may ensue in the Rate Case. The outcome of this activity cannot be prejudged.

**E. *Use Rate Case as a vehicle to apply pressure and to leverage concessions.*** The period for formal comments has expired. Nevertheless, TAC's legislative authority might make the BPA reconsider its positions on Standards for Service and/or the allocation of Rx benefits, given that any serious legal or political disruption of the Subscription process could jeopardize the agency's ability to make its Treasury payments and provoke harsh reactions in the Congress.

These options are not listed in any order of preference or assumed probability. On balance, from a staff perspective, the main underlying question that precedes a decided course of action is: *What position best accommodate the state's multiple interests in maximizing federal power benefits for all customer classes, protecting the region from the erosion or loss of those benefits, and ensuring a successful transition to effective competition in Montana?*

The Committee's choice is contingent in part on the perspective it wishes to take--that is, whether to view the conflict as a singular state whose decision to restructure ought to be accommodated by others, or as a member of a regional grouping that is itself distinct from other parts of the country and is in some ways threatened by pending federal-level decisions that would compel BPA to sell its power at market rates and/or sell its generation assets to the highest bidder.

Governors and other political leaders in the Pacific Northwest still regard BPA as a crown jewel in the regional economy, one that will glitter and glow even brighter 20-odd years from now, when debts to the Treasury have been paid off and electricity prices outside the federal system may be substantially higher than they are now. Others, including members of Congress from outside the region, view BPA as a dinosaur on its last legs. Taking into account this perspective, the prudent course of action may be to maximize access to federal benefits now, before the beast ceases to exist or is transformed into a different sort of creature, one less amenable to principles of preference and regional self-determination.



